

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)
)
Forward-Looking Mechanism) CC Docket No. 97-160
for High Cost Support for)
Non-Rural LECs)

**REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY,
PACIFIC BELL, AND NEVADA BELL**

Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell (collectively, the "SBC LECs") submit these Reply Comments to the comments filed pursuant to the Public Notice, DA 98-848 (released May 4, 1998), on selected issues regarding the proposed universal service forward-looking cost proxy model.

**I. UNIVERSAL SERVICE NECESSARILY REQUIRES THE AVAILABILITY OF
TELEPHONE SERVICE TO ALL HOUSEHOLDS¹**

The section 254 mandate to "preserve and advance" universal service can only be met by making telephone service available to all customers desiring telephone service. The mandate cannot be fulfilled by only counting "occupied housing units" or those "households who currently have phones" or "total housing units." None of the suggested alternatives fully

¹ By use of the term "household," the SBC LECs generally mean all premises within the geographic area to which facilities may be deployed, including business and residential locations.

captures the need to have facilities in place in advance of service demand, the dynamic nature of demand, and the movement of customers from location to location. Moreover, the latter does absolutely nothing to "advance" universal service but instead treats the current subscribership rate as a static objective that, if preserved, meets the Congressional goal. The Commission should thus adopt total housing units and all business locations as the input value to develop the total costs associated with universal service.

Several filings that support using total housing units noted that universal service has for years included the "carrier of last resort" obligation shouldered by incumbent local exchange carriers ("ILECs"). As GTE noted, that obligation includes a "readiness to serve" component that "takes into account that an ILEC must engineer its network and be prepared to provide immediate service to all customers in its area," which includes normal growth and customer churn factors. GTE, p. 9. Similarly, as stated in the joint comments of BellSouth, US WEST, and the Sprint LECs ("LEC Joint Comments"), "[w]hile at any given time, it is true that 100% of the housing units may not need telephone service, the plant is engineered to accommodate all the housing units, because any of the existing housing units may be occupied at any time." LEC Joint Comments, p. 7. Other commenters who actually have undertaken the responsibility of providing universal service agree.² Indeed, the FCC's obligation to "preserve" universal service

² See, for example, Aliant Communication which notes that "[i]f telephone plant is not constructed to all housing units intended for occupancy, it would need to be installed when a 'household' later moves in and subscribes to telephone service," "[o]mitting the investment to serve unoccupied (but intended for occupancy, as defined by the Bureau of Census) housing units understates the costs of providing service," and "[e]stimating the cost of serving only households with telephones at a given point in time is unnecessarily restrictive and not representative of the cost

and the definition of "eligible telecommunications carrier" in section 214(e) with its advertising requirement clearly suggests that the same "readiness to serve" standard applies to and is expected of eligible carriers. Accordingly, to provide support to "preserve" the current status of universal service (including the "readiness to serve" component), total housing units and total business locations must be adopted and the costs associated with deploying a network to those locations must be included in any proxy model.

The SBC LECs thus disagree with comments like those filed by the North Dakota Public Service Commission, which supports including "only occupied housing units." North Dakota PSC, p. 1. Ameritech's proposal to count only households with telephones is equally flawed. Ameritech reasons that to "develop cost for supported services using this universe [of households] will permit an adequate recognition of any economies of scale and scope to existing customers" and that to "expand the universe beyond households with telephones would unnecessarily clutter the calculation of the cost of supported services." Ameritech, p. 2. Telephone networks, and particularly outside plant, used to provide universal service are not deployed in a shotgun, scattered fashion only in reaction to consumers' demand as they move from occupied to unoccupied houses. Looking only at "total occupied housing units" or "households with telephones" does not account for the fact that plant must be deployed (and costs incurred) in preparation for service to unoccupied customer locations, or the fact that a

of providing service over time (even in a period as short as a week)." Aliant, p. 3.

currently unoccupied customer location may at one time been occupied and therefore required telephone service.

The use of any input other than total housing units and total business locations would be inconsistent with the stated objective in developing a forward-looking cost proxy model. As noted by Sprint Local Telephone Companies' ("LTCs") comments, the term forward-looking cost is defined as "... using the least cost, most efficient, and reasonable technology currently available for purchase with all inputs valued at current prices. Sprint LTC, p. 3. As noted by BellSouth, "[e]ven though cost proxy models design a hypothetical network, the cost of that network should reflect real world characteristics. That is, it should reflect the costs that an efficient provider would experience in building and operating that network." BellSouth, p. 4. Those "real world characteristics" would include total housing units and total business locations as the efficient engineering deployment of facilities needed to provide universal service (*e.g.*, copper/fiber, drop, electronics and switching capability) must address the timeliness of being able to provide such services to minimize delay and costs and meet legal obligations. It is simply not efficient, cost effective or timely to deploy telephone plant on a customer location-by-customer location basis depending upon the timing of when a customer location becomes occupied or to remove plant and facilities as homes become unoccupied. Any forward-looking cost proxy model that makes that assumption is fundamentally inconsistent and flawed.

II. ANY REVENUE BENCHMARK ADOPTED BY THE COMMISSION MUST BE LIMITED TO ONLY REVENUES GENERATED BY UNIVERSAL SERVICE PRICES

Only those revenues that are obtained from prices associated with the services and functionalities in the universal service definition should be included in the revenue benchmark. Implicit support essentially involves using revenues obtained from services priced above-cost, and presumably otherwise competitive levels, to permit the pricing of other services below cost.³ AT&T and MCI advocate the continued use of implicit support by suggesting that all revenues that can be expected from the facilities placed to provide basic service should be included in establishing a revenue benchmark. AT&T/MCI even go so far as to suggest that revenues should be included from "currently nonexistent, revenue-producing services." AT&T/MCI, p. 16. Other commenters have suggested that all revenues generated as a result of having an end-user's local exchange service account should be included in the benchmark.

However, the prices currently charged for services such as intraLATA toll, access services and vertical services are several of the most common examples of implicit universal service support. Regulators have historically required these prices to be set well above cost in order to generate revenues necessary to keep universal service prices artificially low. Including these revenue levels in the revenue benchmark means only the implicit support they currently

³ The Commission itself recognized this concept in its universal service order. At note 15, the Commission stated that it found the term "implicit subsidies" to "generally mean that a single company is expected to obtain revenues from sources at levels above 'cost' (i.e., above competitive price levels), and to price other services allegedly below cost." *Report and Order, Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 8776 (1997).

contain will never be identified. The motivation is clear -- having one carrier's prices in a competitive market inflated with universal service support provides competitors with an unwarranted competitive advantage. In order to ensure competitive neutrality, it is imperative that all implicit support is replaced by an explicit support mechanism. Even if the current prices for intraLATA toll, access services and vertical services did not contain implicit support, it would be incorrect to include these revenues in the benchmark because it would understate the true amount of revenue necessary to recover the universal service costs in high-cost areas.

AT&T/MCI do not recognize that incumbent LECs as well as other eligible telecommunications carriers do not have the luxury of investing to serve only customers for which support may not be required. By nature of their service obligation, incumbent LECs and other eligible telecommunications carriers must invest to provide all customers with access to the network while at least incumbent LEC prices for that access continue to be regulated and constrained at levels not otherwise indicative of the market price. In high-cost areas, prices are constrained to below-cost levels. Conversely, in low-cost markets, prices may be constrained above the level that the market would dictate. In either market, the prices for services not included in the definition of universal service may be artificially inflated to produce the inappropriate, implicit support for universal service. There is no guarantee a customer will subscribe to vertical services or make enough toll calls to generate sufficient contribution to offset the costs of local service not recovered from that customer.

The SBC LECs further agree with USTA that "such revenues will no longer be available to support universal service as competitors with no regulatory restraints will continue to target high volume customers." USTA, p. 3. In any instance where an implicit subsidy exists in a price, competitors will easily be able to offer prices below those of the ILEC even when not as efficient as the ILEC. Services priced with embedded, implicit subsidies are simply not sustainable in a competitive market. Competition will necessitate that the ILECs lower their rates on those services providing the implicit subsidy, reducing support to the high-cost rural areas traditionally provided by the more densely populated urban areas. The result will be that the amount of support necessary to be funded through the state and federal universal service funds will be insufficient, as well as discriminatory since all carriers are not contributing to the support of universal service.

III. THE COMMISSION MUST RECOGNIZE, AS MANY COMMENTERS HAVE, THAT CONGRESS HAS MANDATED THAT UNIVERSAL SERVICE PRICES BE PREMISED ON AFFORDABILITY

Section 254(i) states that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable." The definition of affordability from a regulatory perspective should include the customer's ability to bear the cost for universal service. Such an approach would focus on customers within a given geographic area and determines whether or not it is reasonable for customers to pay for the costs of providing them universal service, or whether support is necessary to ensure affordable prices.

Comments filed by the Sprint LTCs indicate an awareness that the FCC should focus on affordability as the premise for any revenue benchmark. Sprint LTCs, p. 4. With the concept of affordability, universal service prices may need to either increase or decrease, depending on the specific geographic area in question. In order to meet the universal service goals under the Act, the affordability of the required price must be assessed to determine if support is necessary.

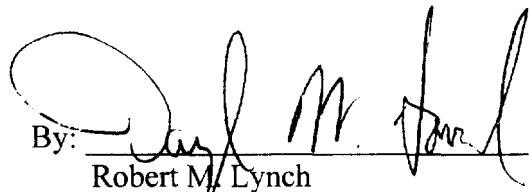
The SBC LECs disagree with comments that the universal service benchmark should be based solely on cost. *See, e.g.,* US West, p. 7. Cost should, and must, be used in the determination of support, but it is only one of the necessary components. However, the need for support should be determined by a comparison of the customer's ability to pay for universal service -- affordability -- with the actual costs of the service. To the extent that the costs exceed the customer's affordability level, the resulting difference is the needed support. If the revenue received from the universal service equals or exceeds the affordability benchmark, support is not needed. A cost benchmark is flawed because it delivers support to a company when a cost threshold is exceeded regardless of what the company's customers pay or can afford to pay for their universal service. One cannot simply assume that the costs of an area characterize the ability of the customers within that area to pay for universal service.

The FCC should begin the process of adopting an affordability based revenue benchmark using the multi-step approach most recently proposed in the SBC LECs' Comments filed in response to the Public Notice. The following three steps should be taken to ensure that universal service support remains available while continuing to evolve toward a full affordability-based

revenue benchmark: (1) initialize the new federal universal service funding mechanism in the immediate time frame, (2) implement a transitional revenue benchmark, and (3) implement an affordability-based revenue benchmark concurrent with the annual access filings for the year 2000.

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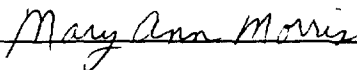
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CERTIFICATE OF SERVICE

I, Mary Ann Morris, hereby certify that the foregoing, "REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL, AND NEVADA BELL," in CC Docket Nos. 96-45 and 97-160 have been filed this 12th day of June, 1998 to the Parties of Record.

A handwritten signature in cursive script, reading "Mary Ann Morris", is written over a horizontal line.

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